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FISCAL IMPACT STATEMENT

LS 6704 | **NOTE PREPARED:** May 4, 2007
BILL NUMBER: HB 1461 | **BILL AMENDED:** Apr 29, 2007

SUBJECT: Tax Exemptions and Credits.

FIRST AUTHOR: Rep. Bosma | **BILL STATUS:** Enrolled
FIRST SPONSOR: Sen. Ford

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *Tax Exemption for Patent-Derived Income:* The bill exempts from taxation certain income derived from qualified patents and earned by a taxpayer. It defines qualified patent to include only utility patents and plant patents. The bill provides that the total amount of exemptions claimed by a taxpayer in a taxable year may not exceed $5,000,000. The bill provides that a taxpayer may not claim an exemption for income derived from a particular patent for more than ten taxable years. It provides that the exemption percentage begins at 50% of income derived from a qualified patent for each of the first five taxable years and decreases over the next five taxable years to 10% in the tenth taxable year. It also specifies that a taxpayer is eligible to claim the exemption only if the taxpayer is domiciled in Indiana and is: (1) either an individual or corporation with not more 500 employees; or (2) is a nonprofit organization or corporation. The bill requires the Department of State Revenue to file an annual report concerning the exemption.

Alternative Fuel Vehicle Manufacturer Tax Credit: The bill establishes the Hoosier Alternative Fuel Vehicle Manufacturer Tax Credit. It provides that the Indiana Economic Development Corporation (IEDC) may award such a tax credit to businesses that make certain qualified investments in Indiana for the manufacture or assembly of alternative fuel vehicles. It also provides that the IEDC determines the percentage of the tax credit, which may not exceed 15%.

Lake County Convention and Visitors Bureau: The bill makes changes to membership qualifications for members of the Lake County Convention and Visitors Bureau (Bureau). It also specifies that the Bureau is a political subdivision for purposes of tort claims against the bureau or its employees.

Effective Date: January 1, 2007 (retroactive); July 1, 2007; January 1, 2008.

Explanation of State Expenditures: *Indiana Economic Development Corporation (IEDC):* The bill will require the IEDC to accept and review applications for the Alternative Fuel Vehicle Manufacturer Tax Credit, and make determinations as to tax credit awards. The bill requires the IEDC to enter into an agreement with tax credit recipients specifying project information and operational information relating to the manufacturing or assembly facilities constructed. The funds and resources required to implement this tax credit program could be supplied through a variety of sources, including the following: (1) existing staff and resources not currently being used to capacity; (2) existing staff and resources currently being used in another program; (3) authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) funds that, otherwise, would be reverted; or (5) new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions. The April 30, 2007, state vacant position report indicates that the IEDC has 33 vacant full-time positions.

Department of State Revenue (DOR): The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the new exemption for patent-derived income and the tax credit for investment in alternative fuel vehicle manufacturing.

The bill imposes additional administrative requirements on the DOR relating to making assessments against taxpayers that do not comply with the requirements of the agreement they executed with the IEDC to receive the tax credit for investment in alternative fuel vehicle manufacturing. In addition, the DOR is required to annually provide an evaluation report to the Legislative Council, the State Budget Committee, and the IEDC relating to the patent-derived income exemption.

The DOR's current level of resources should be sufficient to implement these changes. The April 30, 2007, state vacant position report indicates the DOR has 283 vacant full-time positions.

Explanation of State Revenues: *Tax Exemption for Patent-Derived Income:* The bill would reduce state Adjusted Gross Income (AGI) Tax or Financial Institutions Tax liabilities of taxpayers that derive income from utility patents or plant patents issued after December 31, 2007. The potential revenue loss to the state from this exemption is indeterminable and could begin in FY 2009.

The patent-derived income that would be exempt under the bill is: (1) licensing fees or other income received for the use of a patent; (2) royalties received for the infringement of a patent; (3) receipts from the sale of a patent; and (4) certain income from the taxpayer's own use of the qualified patent to produce the claimed invention. The bill defines a "qualified taxpayer" as: (1) an individual or corporation domiciled in Indiana with 500 or fewer employees, including employees in the individual's or corporation's affiliates; or (2) a nonprofit organization or nonprofit corporation domiciled in Indiana. A taxpayer may claim the exemption for 10 years with respect to a particular patent. The total amount of exemptions for patent-derived income that a taxpayer may claim in a taxable year is $5 M. The maximum exemption translates into a $170,000 reduction in tax liability for an individual taxpayer and a $425,000 reduction in tax liability for a corporate taxpayer or financial institution. Thus, if 10 taxpayers qualify for the maximum exemption amount each year, the annual revenue loss could range from $1.7 M (if all the taxpayers are individuals) to $4.25 M (if all the taxpayers are corporations).

The exemption percentages during the 10-year exemption period applicable to a particular patent are presented in the table below.

	Percent of Patent-Derived Income Exempt
First five years the exemption is claimed for a particular patent	50%
6th year the exemption is claimed for a particular patent	40%
7th year the exemption is claimed for a particular patent	30%
8th year the exemption is claimed for a particular patent	20%
9th and 10th years the exemption is claimed for a particular patent	10%

Since 1995, an average of about 1,500 patents of all types (utility, plant, design, and other patents) have been granted annually to persons or entities in Indiana. However, annual patent totals for Indiana persons or entities have declined in recent years from a high of 1,745 in 2002 to 1,246 in 2005. The annual patent total is attributable primarily to utility patents, with utility patents granted averaging about 1,300 per year since 1995. The annual total for utility patents granted to Indiana persons or entities also has declined from a high of 1,439 in 1999 to 1,108 in 2005. Data is unavailable as to annual total plant patents granted to Indiana persons or entities, however, it appears it does not exceed 100-200 per year based on the above-described averages. In addition, data is unavailable describing the typical income generated by patents granted to persons or entities in Indiana.

Alternative Fuel Vehicle Manufacturer Tax Credit: The bill would reduce state AGI Tax, Financial Institutions Tax, or Insurance Premiums Tax liabilities of individual and corporate taxpayers that make qualified investment in infrastructure, facilities, machinery, and equipment in Indiana to manufacture or assemble alternative fuel vehicles. The bill defines an "alternative fuel vehicle" as a vehicle designed to operate on at least one of the following fuels: methanol, denatured ethanol, and other alcohols; mixtures containing 85% methanol, denatured ethanol, and other alcohols with gasoline or other fuel; natural gas; liquefied petroleum gas; hydrogen; coal-derived liquid fuels; non-alcohol fuels derived from biological material; P-Series fuels; or electricity. The bill requires the tax credit to be determined by the Indiana Economic Development Corporation (IEDC), but prohibits the tax credit from exceeding 15% of the investment made in Indiana by the taxpayer in the taxable year. The IEDC may award credits for investment made between 2007 and 2012, but tax credits awarded during this period may be carried over to years after 2012. <u>The potential revenue loss to the state from this exemption is indeterminable and could begin as early as FY 2008, if tax credits are awarded during 2007.</u>

The tax credit is nonrefundable and is equal to a maximum of 15% of the investment made in Indiana in a taxable year. The credit may not be carried back, but excess credits may be carried forward for up to nine years following the year in which the taxpayer makes the investment. To obtain the tax credit, a taxpayer must apply to the IEDC before making the investment. Upon determination by the IEDC that the proposed investment satisfies the tax credit requirements, it must enter into an agreement with the taxpayer, that must include: (1) a description of the project; (2) the first year the tax credit will be claimed; (3) the amount of tax credit allowed each year; (4) a requirement to maintain operations at the project site for the 10 years the credit is available; and (5) employment and payroll requirements at the project site. If the IEDC determines that the taxpayer is not complying with the requirements of the tax credit agreement, the Department of Revenue must make an assessment against the taxpayer which may not exceed the total tax credits allowed the taxpayer.

The bill also prohibits a taxpayer (including pass through entities and shareholders, partners, or members of pass through entities) from receiving the tax credit if the taxpayer receives one of the following tax credits for the same project.

(1) Enterprise Zone Investment Cost Credit.
(2) Industrial Recovery (Dinosaur) Tax Credit.
(3) Military Base Recovery Tax Credit.
(4) Military Base Investment Cost Credit.
(5) Capital Investment Tax Credit.
(6) Community Revitalization Enhancement District (CRED) Tax Credit.
(7) Venture Capital Investment Tax Credit.
(8) Hoosier Business Investment Tax Credit.

Explanation of Local Expenditures: *Lake County Convention and Visitors Bureau (CVB):* The bill makes several changes relating to the Lake County Convention and Visitors Bureau (CVB).

(1) The bill provides that the Lake County CVB is a political subdivision for purposes of the Indiana Tort Claims Act.

(2)The bill specifies that appointing authorities of members of the Lake County CVB must give sole consideration to individuals who are knowledgeable about or employed as executives or managers in a hotel, motel, restaurant, travel, transportation, convention, or trade show business in Lake County. Currently, the appointee must be knowledgeable or interested in these fields. The bill adds riverboat casino, banking, real estate, and construction to the list of fields in which a CVB member is knowledgeable or is employed as an executive or manager.

(3) The bill allows Lake County CVB funds to be expended to promote and encourage conventions, trade shows, special events, recreation, and visitors within or outside of Lake County. Current statute limits such expenditures to these activities in Lake County, unless the Lake County CVB has entered into an agreement to establish a Joint CVB.

(4) The bill specifies that the Lake County CVB pay its expenses from funds established by the CVB. Current statute specifies that expenses are to be paid only from the Convention, Tourism, and Visitor Promotion Fund. This Fund contains revenue received from the Lake County Innkeepers Tax distributed to the CVB.

(5) The bill requires the annual budget prepared by the Lake County CVB to be submitted to the Department of Local Government Finance and placed on file with the Lake County Auditor.

Explanation of Local Revenues: *Tax Exemption for Patent-Derived Income:* Because the exemption for individuals receiving patent-related income would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

Lake County Innkeepers Tax: The bill amends a provision regarding the distribution of a portion of the Lake County Innkeepers Tax. Under current statute, 9% of the first $1.2 M in annual revenue from the tax is distributed among cities and towns in Lake County. Current statute unchanged by the bill provides for Gary, Hammond, and E. Chicago to each receive 10% of this revenue share. Current statute provides that 5% shares are to be distributed to the remaining cities and towns in Lake County. The bill provides that the remaining 70% of this revenue share is to be divided equally between the remaining cities and towns in Lake County. There are four cities (besides Gary, Hammond, and E. Chicago) and 12 towns in Lake County to which this distribution would be made.

The bill also specifies that the Lake County Innkeepers Tax revenue distributed to the cities and towns may be used for tourism projects in addition to economic development projects as allowed under current statute.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation.

Local Agencies Affected: Counties with a local option income tax. Lake County CVB; Lake County Commission; Lake County Council; cities and towns in Lake County.

Information Sources: U.S. Patent and Trademark Office, Electronic Information Products Division, http://www.uspto.gov/web/offices/cio/cis/prodsvc.htm.

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